THE MACLEAN LAW FIRM, LLC
100 PARK AVENUE, 20TH FLOOR
NEW YORK, NY 10017
T. (212) 682-1555
F. (212) 682-6999
E. INFO@MACLEAN-LAW.COM
W. MACLEAN-LAW.COM

NEWSLETTER
WINTER 2006

Year End Planning – Non Charitable Gifts, Tuition, Medical Expenses and the Kiddie Tax Expansion

Here we are again with some year-end reminders and updates. And remember too, that the end of the year is not the only time to plan.

Children, Loved Ones, Charities – Many of our clients have told us that they are interested in helping their children during their lives, rather than just passing on their assets at death. This can make sense for many reasons. For example, a child may need funds now for a down payment on a home, or for repairing or replacing property damaged as a result of a storm, fire, or other disaster. You may have new grandchild on the way and your children may need to build another room or move to a bigger apartment. You may desire to help one of your children or loved one start a business, pay for school (or their children's school), or pay someone's medical expenses.

In addition to the help lifetime gifting provides to your family and loved ones, it can reduce your Federal estate and state death taxes and, in some instances, your income taxes. And it's often possible to structure gifts so that no gift tax will be due.

Annual Gift Tax Exclusion Amount Gifts – If you have not already made use of your annual gift tax exclusion amount this year (it's up to $12,000 for 2006), consider making gifts to family members (children and grandchildren) or other loved ones. Hopefully by now you and your income tax advisor know your income and financial picture for the year and how much you can afford to give.

From a gift tax perspective, the first $12,000 of gifts you make to each donee in calendar year 2006 is excluded from the amount of your taxable gifts. If you're married, you and your spouse can combine your gifting ("gift splitting" in IRS parlance) and give $24,000 together to each donee.

Non-Citizen Spouses – For gifts to non-citizen spouses, you can give up to $120,000 without any gift tax consequences. In 2007, this amount goes up to $125,000.

Pre-Paying Tuition, Annual Gifts vs. 529 Plans – Tuition payments for another person made directly to a school, regardless of the amount of the tuition, are not treated as a taxable gift. We remind you again that this exclusion is good for tuition in future years as well. This means that a person can pay up to the ***ENTIRE*** private school or college tuition of a child, grandchild, or anyone else. The gift is not subject to gift taxes and reduces your taxable estate.

Schools differ on whether this type of pre-payment avoids future tuition increases. As these increases may be significant, establishing a separate fund may be appropriate for your estate planning.

Under the Internal Revenue Code, however, tuition means tuition only – not books, living expenses, or extra curricular activities. Thus, paying or prepaying multiple years of tuition does not cover books, room and board, and many other expenses of private school and college education. This is where contributions to 529 Plans and Coverdale accounts can be very useful.

Distributions from 529 Plans can be used for tuition, books, and room and board. Contributions to 529 Plans ("tax-favored qualified tuition programs") and Coverdell education savings accounts don't qualify for the tuition exclusion discussed above. They are treated as present gifts that can qualify for the gift tax annual exclusion (i.e., part of the $12,000 per donee), with the option of spreading contributions in a single year over a five-year period (i.e., $60,000 this year, but no gifts in the next four years).

The recently enacted Pension Protection Act of 2006 (see our Fall 2006 Newsletter) made distributions from 529 plans for "qualified higher education expenses" permanently tax exempt, but did not make Coverdell accounts permanently exempt. Without further action by Congress before 2012, the current $2,000 per year contribution limit for Coverdell's will revert to $500 and the money will no longer be available for kindergarten through grade 12 education expenses. The Act also authorized the Treasury to draft regulations to curb abuses of 529 Plans, where a donor may try to change the designated beneficiaries of the account from multiple beneficiaries of the account to benefit one child or the donor.

Remember to speak with your financial advisor about what investment options he or she can provide for a 529 Plan or Coverdale account. Investment returns can vary widely and how the plan or account is invested can make a big the difference in how much money is there for all those education expenses down the road.

Medical Gifts – A payment of another's medical expenses directly to the medical provider does not impact your annual $12,000 exclusion amount. Moreover, payment of another's medical insurance premiums also does not impact the $12,000 exclusion amount.

Real Life: Recently a client informed us that a child had severely injured herself skiing and would require arthroscopic surgery, along with months, if not years, of physical therapy to recover. The child had recently moved from across the country and lost track of getting new health insurance coverage in the new state of residence. Notwithstanding our legal services to get coverage from the insurance provider in the child's old state of residence, our client was financially able to make the payments directly to the medical professionals who treated the child. The client, grateful that the injuries sustained were not more severe, was pleased to know that these payments, although substantial, did not impact the existing lifetime gifting program that the client has in place. We counsel all our clients to have health care insurance and, assuming they can afford it, to offer to pay the health insurance premiums for any non-covered children or grandchildren, especially if their family members see them as a "safety net."

Estate Tax Reduction Potential –Although $2 million is exempt from Federal estate tax this year (and it stays at $2 million through 2008), when you add the value of your home, other real estate, business assets, retirement assets, savings, investments, and personal property items, coupled with the proceeds of any life insurance policies that may be includible in your estate, you may be within the reach of the Federal estate tax. You can reduce your potential estate taxes by making annual exclusion gifts because the cash (or other assets) comprising the gifts, and the post-transfer growth in their value, are removed from your estate at no transfer tax cost. Moreover, state death tax exemptions may be lower than the Federal exemption. New York State is $1 million and New Jersey is $675,000, so that even if making that gift is not necessary to save Federal estate tax, it could save your family estate state death taxes.

Completion of the Gift – If you have made or plan to make annual exclusion gifts to one or more individuals this year, make sure that you "complete" the gift before the end of the calendar year. If the gift is by check, this means that the check is deposited in the donee's account before the end of the year. The last business and banking day of 2006 is Friday, December 29th, unless your bank is open on the weekends (some are now). Please see our Winter 2005/2006 Newsletter for the technical requirements under the Internal Revenue Code for making a completed gift other than by check to a non-charitable donee.

Last Minute Income Tax Planning with Charitable and Non Charitable Gifting – Beyond the cliché that "charity begins at home" is the realm of philanthropy. We have advised many of you on what we call Family Concentric Philanthropy and we will be writing more on that in Newsletters in 2007.

Many of you will have already consulted with your income tax advisor and determined how much, if any, more charitable gifting you will make before the end of the year. Like gifts to non-charities, you must make an irrevocable gift before the end of the calendar year for it to be effective in 2006. What is irrevocable in the realm of wire transfers and ADT transfers is not the same as irrevocable when using a check. We invite you to contact us with regard to any charitable contributions you may be considering for 2006 and for 2007.

Kiddie Tax Relief No-More – Last winter we reminded you that there was the potential for income tax savings under the "Kiddie Tax" provisions. Under the old law, a child through age 13 who could be claimed on his or her parent's income tax return paid no income tax on the first $800 of income (including income in an UTMA or UGMA account). The next $800 was paid at the child's rate; typically 10% or 15% for ordinary income and 5% for capital gain income. If the child had income over $1,600, then that income was taxed at the parent's rate – up to three times higher (35% for ordinary income and up to 15% for capital gains income). The "Kiddie Tax" was designed to prevent rich people from transferring assets to their children for income tax purposes. The provisions ended when the child reached age 14. Then, all income was taxed at the child's rate. Thus, from age 14 to 18, by transferring capital gain assets to your dependent child age 14 or older, those assets could be sold and taxed at the lower rates. If the assets were targeted to pay for junior's college, why not sell them at his rate instead?

Effective January 1, 2006, the Tax Increase Prevention and Relief Act of 2005 ("TIPRA") effectively extended the Kiddie Tax to age 18. Now, a dependent child with more than $1,700 of unearned income pays income tax at his or her parent's rate until age 18. At age 18, the "child" is taxed at his or her own rates. So, if you have a dependent child who will not turn age 18 before December 31, 2006, and has more than $1,700 of unearned income, please contact your tax advisor to discuss TIPRA's ramifications on your family.

And with that, a Happy New Year to All.

The following disclosure is required pursuant to IRS Circular 230, which sets forth best practices for tax advisors: Any tax advice contained in the above communication is not intended or written to be used, and cannot be used, for the purpose of avoiding tax penalties or promoting, marketing or recommending to another party any transaction or matter addressed in this communication. If you would like a written opinion on the one or more Federal tax issues addressed above upon which you may rely for the purpose of avoiding penalties please contact us.

For more information please contact us at 212-682-1555 or by email at info@maclean-law.com.